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SURFACE TRANSPORTATION BOARD[1]

DECISION

No. 40073

SOUTH-WEST RAILROAD CAR PARTS COMPANY
v.
MISSOURI PACIFIC RAILROAD COMPANY

Decided: December 27, 1996

At issue here is the reasonableness of a $300 per car rate previously charged by defendant Missouri Pacific Railroad Company (MP)[2] to complainant South-West Railroad Car Parts Company (SWRC) for the transportation of retired rail cars moving on their own wheels. On reopening, we preliminarily find that the rate was not unreasonably high and thus did not violate former 49 U.S.C. 10701a(b)(1).

BACKGROUND

SWRC filed a complaint with the ICC in December 1985, alleging that the flat rate of $300 per car charged by MP for the movement of retired railroad cars from five points in Texas and Louisiana[3] to SWRC's salvage yard in Greggton, TX, was unreasonably high in violation of former 49 U.S.C. 10701a.[4] SWRC purchased the retired cars from other railroads, who delivered them to the point of interchange with MP. MP then moved the cars for SWRC from the various interchange points to the MP yard at Longview, TX, where the cars were accumulated for periodic

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[1] The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995) (ICCTA), abolished the Interstate Commerce Commission (ICC) and transferred certain functions to the Surface Transportation Board (Board), effective January 1, 1996. Under section 204(b)(1) of the ICCTA, proceedings that were pending before the ICC on the effective date of that legislation shall be decided under the law in effect prior to January 1, 1996, insofar as they involve functions retained by the Board. This decision relates to a proceeding that was pending with the ICC prior to January 1, 1996, and to functions that are subject to Board jurisdiction pursuant to new 49 U.S.C. 10701. Therefore, this decision applies the law in effect prior to the ICCTA. This decision uses "former" to refer to the pre-ICCTA statutory provisions applied here (i.e., the law in effect on December 31, 1995) and "new" to refer to their post-ICCTA counterpart provisions (i.e., the law in effect on January 1, 1996).

[2] MP was (when the complaint was filed), and remains, a separate subsidiary of the Union Pacific Corporation, which also owns the Union Pacific Railroad Company (UP). In 1985, the two railroad subsidiaries began to file consolidated financial data. Thus, the variable cost computations in this decision reflect the unit costs for all UP operations, including MP unit costs.

[3] The five origin points were Dallas, TX; Ft. Worth, TX; Shreveport, LA; Texarkana, TX; and Big Sandy, TX.

[4] The rate reasonableness requirement of former section 10701a was reenacted in new 49 U.S.C. 10701(d)(1).

movement to SWRC's plant at Greggton. At Greggton, SWRC dismantled the cars to recover scrap and resalable parts.

SWRC originally sought both reparations for past movements and the prescription of a reasonable rate for future movements. However, SWRC later relocated its business and, as a result, MP canceled the challenged rate on April 20, 1988.[5] The request for a rate prescription is thus mooted.

In an initial decision, served December 4, 1986, an ICC administrative law judge (ALJ) concluded that MP had market dominance over this traffic,[6] but that the rate could not be found unreasonably high absent a showing by SWRC of the maximum reasonable rate level. SWRC filed an administrative appeal.[7]

In a decision served July 10, 1987, the ICC affirmed the ALJ's market dominance findings, but not his treatment of the rate reasonableness issue. The ICC concluded that it was not SWRC's responsibility to develop a methodology for evaluating maximum rate reasonableness. Instead, the ICC attempted (unsuccessfully) to determine the maximum reasonable rate level itself.

The ICC first found that it could not apply the Coal Rate Guidelines[8] to this case, because they entail a presentation that would be prohibitively expensive, if not impossible, for a low-volume shipper such as SWRC to make. Instead, the ICC proposed to evaluate this rate using the "formula replacement cost" (FRC) test that was proposed in Rate Guidelines--Non-Coal Proceedings, Ex Parte No. 347 (Sub-No. 2) (ICC served Apr. 8, 1987) (Non-Coal '87).

Subsequently, in a decision served March 16, 1988, the ICC abandoned the FRC method in favor of the comparative revenue-to-variable cost (R/VC_{COMP}) test that had also been proposed in Non-Coal '87. The R/VC_{COMP} test compares the revenue contribution made by the traffic at issue--expressed as the percentage of revenues to variable costs (r/vc) attributable to that traffic--to the average revenue contribution (r/vc level) made by similar traffic.

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[5] The rate, which became effective on November 6, 1985, was never increased. It remained at the $300 level until it was canceled.

[6] See former 49 U.S.C. 10709, reenacted as new 49 U.S.C. 10707.

[7] SWRC's complaint also alleged that the rate violated former 49 U.S.C. 10726 (the so-called long- and short-haul provision, which was repealed by the ICCTA) and 10741 (which prohibited unreasonably discriminatory rates and was reenacted by the ICCTA under the same section number). The ALJ found no violation of former sections 10726 or 10741, and SWRC did not appeal those rulings.

[8] Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). Notwithstanding the title, the procedures developed there are used to evaluate the reasonableness of the rates charged on any high volume, repetitive rail traffic, regardless of the commodity involved.

"Variable costs" are the portion of the rail industry's costs that have been found to vary with the amount of traffic and thus can be readily assigned to specific traffic. Carriers also incur, and must be able to earn sufficient revenues to recover, a considerable amount of "fixed" costs that do not vary with the amount of traffic and thus cannot be specifically attributed to particular services. Because the railroad industry has a high degree of non-variable costs, the markup that a carrier must be permitted to charge above variable costs can be substantial. Moreover, because of the mix of captive and competitive traffic handled by the rail industry, rail carriers must be able to differentially price their services based on demand. In other words, they must charge higher markups on their relatively demand-inelastic (captive) traffic than on their more demand-elastic (competitive) traffic. See Coal Rate Guidelines.[9] The R/VC_{COMP} test seeks to determine the extent of the markup that is appropriate for the challenged traffic based on the size of the markup charged on similar traffic with a presumptively similar degree of demand inelasticity.

The R/VC_{COMP} test was designed to rely on comparison traffic composed of similar commodities moving under similar transportation conditions.[10] However, because a statistically adequate sample of comparison movements of scrap cars moving on their own wheels could not be found, the ICC substituted a comparison group consisting of movements of iron and steel scrap. In a decision served December 12, 1988, the ICC used the average r/vc level for the iron and steel scrap comparison group (228%) as a cap on what MP could charge to the SWRC traffic and awarded reparations on that basis.

Both MP and SWRC challenged that decision in court on three grounds: (1) the propriety of the R/VC_{COMP} test as a maximum rate standard; (2) the validity of the comparison group selected in this case; and (3) the apparent lack of a majority consensus among the ICC Commissioners for the use of that particular comparison group. Rather than defend its 1988 decision, the ICC reopened this case on June 1, 1990. Prompted by its experience in this case and by a judicial remand of another case in which the R/VC_{COMP} test had also been applied,[11] the ICC resumed its search for a suitable simplified method for evaluating the reasonableness of rates in cases where the Coal Rate Guidelines are inappropriate.

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[9] Demand elasticity is a measure of the price-sensitivity of the demand for a particular product. Coal Rate Guidelines, 1 I.C.C.2d at 523 n.8. For traffic that is completely demand-inelastic, the amount shipped would be unaffected by rate changes.

[10] The comparison traffic is limited to shipments with an r/vc level above 180%. Congress used this 180% r/vc level as the floor for market dominant pricing and the need for regulatory scrutiny. See former 49 U.S.C. 10709(d)(2), reenacted (with modifications) as new 49 U.S.C. 10707(d)(1)(A).

[11] McCarty Farms v. Burlington N. Inc., 4 I.C.C.2d 262 (1988), remanded, Burlington N.R.R. v. ICC, 985 F.2d 589 (D.C. Cir. 1993), reopened, McCarty Farms v. Burlington N. Inc., No. 37809 (ICC served Mar. 26, 1993). Upon remand, the parties agreed to apply the Coal Rate Guidelines to the McCarty Farms case, which is currently pending at the Board.

In a decision served December 1, 1995, in Rate Guidelines--Non-Coal Proceedings, Ex Parte No. 347 (Sub-No. 2) (Non-Coal '95), the ICC abandoned the search for a one-size-fits-all test to serve as a rate cap in those cases where the Coal Rate Guidelines are not appropriate. Instead, it proposed using a combination of three different r/vc benchmark measures as the springboard for a case-specific rate reasonableness analysis.[12] After reviewing that proposal and the public comments that were received, we have decided to adopt that proposal, in a separate decision in that proceeding (Non-Coal '96), issued concurrently with this decision.

As explained in both the Non-Coal '95 and Non-Coal '96 decisions, each of the three r/vc benchmarks offers a different and instructive perspective on the reasonableness of a rate, but each is incomplete and none could be relied upon as the sole standard of reasonableness.[13] Moreover, an average rate figure should not be applied mechanically in such a way as to make it a rate cap.[14] Thus, the three r/vc benchmarks are intended to provide only the opening analytical tools for a broader, more searching inquiry into the reasonableness of a particular rate.[15]

The first r/vc benchmark is the "Revenue Shortfall Allocation Method" (RSAM) measure. RSAM represents the average markup over variable costs that a defendant railroad would have to attain from all of its relatively demand-inelastic traffic (traffic moving at r/vc levels greater than 180%)[16]--if all of this traffic were priced at the same r/vc level--in order for the carrier to recover its costs (both variable and fixed) and earn an adequate return. RSAM supplies a key component of a simplified rate reasonableness analysis, because it takes into consideration a carrier's need to earn adequate revenues, as required by former 49 U.S.C. 10701a(b)(3).[17]

As adopted in Non-Coal '96, RSAM constitutes a range, with the unadjusted RSAM figure as the upper end of the range and an efficiency-adjusted RSAM as the lower end. The efficiency adjustment removes any revenue shortfall that results from pricing any traffic below variable cost. This adjustment allows

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[12] While the ICC suggested a possible means of combining the three r/vc benchmarks into one formula, it emphasized that such a formula would provide no more than a rebuttable presumption as to a reasonable markup. The rate reasonableness analysis would then necessarily become case-specific. Non-Coal '95 at 25, 30.

[13] Non-Coal '95 at 25.

[14] Id. at 20-22.

[15] Id. at 17, 25.

[16] Again, we use 180% as the r/vc threshold for relatively demand-inelastic traffic because Congress determined that traffic priced below that level does not require regulatory oversight (i.e., is presumptively priced at competitive levels). See former 49 U.S.C. 10701a(b)(1), 10709(d)(2) (reenacted as new 49 U.S.C. 10701(d)(1)), 10707(d)(1)(A), respectively).

[17] Non-Coal '95 at 18, 24. Former section 10701a(b)(3) was reenacted as part of 49 U.S.C. 10701(d)(2).

us to take into consideration the carrier's pricing of the portions of its traffic that are not within our regulatory purview, as required by former 49 U.S.C. 10707a(e)(2)(C)(i)-(ii).[18] The adjustment is meant to protect the relatively demand-inelastic traffic from cross-subsidizing noncompensatory traffic.[19] Because of the limitations of the data and the variable costing procedures that we have, however, we cannot accurately determine the point at which cross-subsidization begins to occur for specific traffic. Because we believe that point is somewhere between the adjusted and unadjusted RSAM figures, we will use the range between those two figures as our initial guide in a rate reasonableness analysis.

The second r/vc benchmark is the R/VC_{COMP} measure discussed above. As the ICC explained, this figure (where available) adds to the analysis by gauging (albeit crudely and indirectly) the relative degree of demand elasticity associated with the challenged traffic.[20] This is instructive because railroads are expected to differentially price their traffic in inverse relation to the demand elasticity of each component of traffic. Coal Rate Guidelines, 1 I.C.C.2d at 526-27.

The third r/vc benchmark is the $R/VC_{>180}$ measure, which looks at the extent to which the defendant carrier is marking up its other relatively demand-inelastic traffic (traffic with r/vc levels greater than 180%) on average. This measure considers the fairness of the carrier's rate structure, as required by the so-called third Long-Cannon factor in former 49 U.S.C. 10707a(e)(2)(C)(iii).[21] A comparison of this benchmark with the r/vc percentage for the traffic at issue indicates how much a particular shipper's markup deviates from the norm for that carrier's relatively demand-inelastic traffic (the >180 traffic).

The $R/VC_{>180}$ measure shows the average level for the differential pricing applied across the broad spectrum of a carrier's demand-inelastic traffic. Such a measure may be more

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[18] Non-Coal '95 at 18-19, 24. See former 49 U.S.C. 10707a(e)(2)(C)(i) (the rate reasonableness analysis shall consider the amount of traffic moving at rates that do not contribute to going concern value), 10707a(e)(2)(C)(ii) (the analysis shall also consider the amount of traffic which contributes only marginally to fixed costs) (reenacted as new 49 U.S.C. 10701(d)(2)(A) and (B), respectively).

[19] It is well established that pricing certain traffic below variable cost may be entirely reasonable and economically efficient in the short-term. Coal Rate Guidelines, 1 I.C.C.2d at 537 & n.41. But it is equally well established that captive shippers should not be required to cross-subsidize such traffic. Id. at 537-38.

[20] Non-Coal '95 at 21, 24.

[21] Non-Coal '95 at 23-24. Former section 10707a(e)(2)(C)(iii) instructed us to consider "the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues." That provision has been reenacted as new 49 U.S.C. 10701(d)(2)(C).

instructive, however, when refined to focus on a subset of the carrier's traffic that is like the traffic at issue.[22]

DISCUSSION

Decision To Proceed With This Case

We concur in the ICC's finding that this case is not suitable for handling under the Coal Rate Guidelines. This is clearly a small case. The challenged rate was only in effect for two and a half years, and the volume of traffic was limited. Although neither party submitted comprehensive volume data for this traffic, MP's evidence indicates that about 865 cars per year were involved.[23] On that basis, the total freight bill for this traffic would have been less than $260,000 per year[24] or less than $670,000 for the entire period during which this rate was in effect.[25] Moreover, any rate relief that SWRC could receive would be limited by the 180% r/vc jurisdictional boundary. Thus, the most that SWRC could receive in reparations would be the difference between the amounts that it paid to MP for this traffic (which we calculate at an r/vc level of 242%) and the floor for a regulatory challenge (the 180% r/vc level), which in this case would constitute a maximum 26% potential rate reduction.[26] This equates to a maximum potential recovery of less than $175,000 (plus interest).[27] The expense of readjudicating this case under the stand-alone cost procedures of Coal Rate Guidelines would likely exceed any such potential recovery.

Accordingly, we believe that this long-pending case can and should be resolved under the simplified approach adopted in Non-Coal '96.[28] Moreover, we do not believe that it is necessary to delay this case further by requiring the submission of additional evidence or arguments, unless a party wishes to make such a submission. We can make an initial evaluation of the reasonableness of the rate at issue here using the analytical tools (r/vc benchmarks) outlined in Non-Coal '96. We base our analysis on the record already before us (which contains information regarding the traffic at issue in this case), other information at our disposal regarding the pricing of other traffic (drawn from the rail industry Waybill Sample), and our standard costing procedures.

By proceeding with this case, we do not intend to foreclose the parties from presenting further evidence and/or argument if they wish to do so. Should either party wish to submit

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[22] Non-Coal '95 at 23.

[23] MP's Mar. 28, 1986 reply statement Appendix EJB-1.

[24] 865 cars/year x $300/car = $259,500/year.

[25] $259,500/year x 2.5 years = $669,510.

[26] 1 - (180/242) = .26

[27] $669,510 x .26 = $174,072.

[28] We note that the parties to this proceeding had the opportunity to participate in the Non-Coal proceeding and address the adoption of these benchmarks.

additional evidence and/or argument in light of this decision, we invite it to do so, through an appropriate filing.

Measurement of This Rate

The first step in our analysis is to determine the revenue contribution of the traffic at issue (i.e., the markup charged on this traffic), as measured by the r/vc level. These calculations are shown in the following table.

R/VC Percentages For The Issue Traffic

Origin & Distance	1986	1987	1988	Composite
Dallas, TX[29] -- 124.5 mi.	255%	244%	219%	
Ft. Worth, TX -- 154.9 mi.	242%	231%	210%	
Shreveport, LA -- 69.5 mi.	267%	255%	227%	
Texarkana, TX -- 93.5 mi.	269%	258%	227%	
Big Sandy, TX -- 23.1 mi.	310%	296%	256%	
Weighted Average[30]	258%	247%	221%	242%

We assess the reasonableness of the challenged rate on the same terms as the carrier set the rate. Because the rate at issue was established as a group rate applicable from all five origins, we will not separately judge the rate as it applies from each origin; rather, we will consider the weighted average cost of all movements.[31] Further, because the challenged rate remained constant over the entire period covered by the complaint, we will evaluate the rate on a composite basis over that period.

Reasonableness Analysis

We start our analysis where the ICC left off in this case, with the R/VC_{COMP} test. After reexamining the issue, we share the parties' concerns regarding the use of iron and steel scrap movements as a comparison group. The traffic at issue is sufficiently different from iron and steel scrap movements that we cannot assume that the demand elasticity would be sufficiently similar for the two sets of traffic. As the parties have pointed out,[32] the retired railroad cars involved here were not used entirely for scrap--some parts were reconditioned and sold as spare parts, and some cars were entirely refurbished. Furthermore, the scrap content was not limited to iron and steel (the only commodities in the comparison group), but included aluminum, brass, and stainless steel. Finally, the retired cars moved on their own wheels, whereas the scrap traffic in the comparison group was loaded onto rail cars that required a return

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[29] Over 90% of the traffic is from Dallas.

[30] The composite variable cost figure is weighted by the volumes of traffic from each origin. (The revenue is the same for all movements because the rate was a flat per-car charge.)

[31] Accord, Amstar Corp. v. The Atchison, T.&S.F. Ry., No. 37478 (ICC served Sept. 28, 1995), at 4.

[32] See the verified statements of witnesses Toramina (at 24-27), Fauth (at 6-11), and Collins/Hauck (at 3-9).

movement. Thus, neither the nature of the commodities nor the transportation conditions were similar.

Given the unusual nature of the traffic at issue, we are not able to identify another suitable comparison group for use here. Without an acceptable comparison group, we are unable to include the R/VC_{COMP} benchmark in our analysis in this case.[33]

We turn, then, to the particular pricing considerations that apply to MP, as part of the UP railroad system (see n.2 above). We first consider the carrier's revenue needs, as measured by the RSAM range. We have computed the RSAM levels for UP for the years involved, as shown in the following table:

UP'S RSAM Range

1986	1987	1988	Composite
204%-229%	224%-266%	221%-261%	216%-252%

This tells us that the markup received from the SWRC traffic (242%) was within the range that was needed, on average, to meet UP's revenue needs.

To complete our analysis, we look at how other relatively demand-inelastic traffic served by the UP system was actually priced (the $R/VC_{>180}$ measure). Applying standard costing procedures and waybill information, we computed the average $R/VC_{>180}$ figures for UP for the years during which the challenged rate was in effect, as shown in the following table.

UP'S $R/VC_{>180}$

1986	1987	1988	Composite
237%	221%	225%	228%

This tells us that MP assigned a higher average markup to the challenged traffic than the average markup for all relatively demand-inelastic traffic served by the UP system. However, carriers are not expected to price their traffic uniformly; they are expected to price differentially. Therefore, we must consider whether it was appropriate for this traffic to receive a higher markup and, if so, whether it was appropriate for it to be at the level at which it was set.

For that purpose, we look at the subset of UP's >180 traffic that most closely compares to the traffic at issue, as suggested in Non-Coal '95 and Non-Coal '96. SWRC's traffic consisted entirely of single-car single-line traffic moving short distances. Intuitively, one would expect such traffic to receive a higher markup than traffic moving longer distances in larger volumes using multiple-car and unit-train pricing. The traffic and pricing information contained in the Waybill Sample confirms that this was the case, as shown in the following table.

Pricing of Comparable UP >180 Traffic

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[33] As a result, we are also unable to apply the combined formula outlined in Non-Coal '95 and Non-Coal '96.

Type	1986	1987	1988	Composite
All Single Car (SC)	243%	221%	226%	231%
All Single Line (SL)	251%	226%	234%	238
SC/SL < 100 miles	266%	253%	254%	258%
SC/SL & 100-199 miles	255%	248%	247%	250%

Because over 90% of the issue traffic originated at Dallas and moved a distance of 125 miles, the last line of the table provides the most instructive figures. It shows that MP's pricing of the issue traffic (at a composite r/vc level of 242%) is less than the average markup charged by the UP system at that time for short-distance single-line single-car relatively demand-inelastic traffic (which had a composite average r/vc level of 250%). In other words, the SWRC traffic did not receive a disproportionately high markup for that type of traffic; to the contrary, its markup was below-average for such traffic.[34]

CONCLUSION

An initial application of the Multiple R/VC Benchmarks approach adopted in Non-Coal '96 indicates that the challenged rate was not unreasonably high. Notwithstanding our initial conclusion, SWRC may introduce further evidence or argument to show that the markup collected on its traffic was too high, if it wishes to do so, within 60 days. If it chooses not to do so, this initial conclusion will become our final determination.

This decision will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Unless the complainant files an appropriate request for further consideration by March 3, 1997, the complaint is dismissed.

2. This decision is effective on January 30, 1997.

By the Board, Chairman Morgan, Vice Chairman Simmons, and Commissioner Owen.

Vernon A. Williams
Secretary

[34] Indeed, we note that, during the 1986-88 period, a full 30% of all of UP's relatively demand-inelastic traffic had a higher markup than the SWRC traffic.